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## S. 442 — Internet Tax Freedom Act

Calendar No. 509

*Reported July 30, 1998, by the Senate Committee on Finance, with an amendment in the nature of a substitute, by a vote of 11-1 (Senator Graham voting nay). S. Rept. 105-276, additional views filed. Reported May 5, 1998 by the Senate Committee on Commerce, Science, and Transportation, with an amendment in the nature of a substitute, by a vote of 14-5 (Senators Gorton, Hutchison, Ford, Byran, and Dorgan voting nay). S. Rept. 105-184, additional views filed.*

### NOTEWORTHY

- S. 442 may come before the Senate as early as Wednesday of this week. At press time, there was no unanimous consent agreement governing the bill's consideration. The Administration is anticipated to be supportive of S. 442 [see Administration Position].
- S. 442 was reported by both the Commerce and Finance Committees. The underlying bill for floor consideration will be the Finance Committee substitute, amended further by a managers' (Senators McCain and Hollings) amendment. This Notice reflects changes made by the managers' amendment as of September 22; other changes prior to its introduction are possible.
- The Finance bill imposes a moratorium, beginning July 29, 1998 and ending two years after the date of enactment of the bill, on certain state and local taxation of online services and electronic commerce. The Commerce Committee substitute imposes a six-year moratorium on online services (until January 1, 2004). Senators McCain and Wyden may offer an amendment to make the moratorium five years.
- During the moratorium, an advisory commission is created to study and recommend to Congress, within 18 months, the appropriate taxation (domestic and international) and tariff treatment of Internet activity.
- The House on June 23, 1998 passed a similar bill, H.R. 4105, under suspension (with no roll call vote). H.R. 4105 would impose a three-year moratorium and an advisory commission would submit its report within two years of enactment.

## **BACKGROUND**

Electronic commerce is estimated to have generated \$8 billion in 1997, and is expected to grow to over \$300 billion in 2002 [see Commerce Report, p. 1]. While most states and local governments have not yet imposed taxes on Internet activities, widespread concern has been voiced that if state and localities are allowed to impose potentially unpredictable and overly burdensome taxes on Internet activity, it could stunt the growth of electronic commerce and make Internet use uneconomical for many companies.

### ***Committee Action***

On May 5, 1998, the Commerce Committee marked up S. 442, "the Internet Tax Freedom Act" with an amendment in the nature of a substitute (S. Rept. 105-184). That amendment would impose a six-year moratorium (through Jan. 1, 2004) on state and local taxes that discriminate against communications and transactions using the Internet, and online services and Internet access service. The moratorium would not apply to taxes on net income derived from the Internet, to fairly apportioned business taxes applied to businesses having a business location, or to sales or use taxes that are generally applicable taxes and imposed in the same manner as is permitted on sales, or transactions effected by mail order, telephone, or other remote means.

The Commerce substitute would create a Consultative Group to examine current tax policies and to develop recommendations regarding the taxation of Internet communications and transactions. The Commerce bill directs the Secretaries of State, Treasury, and Commerce, in consultation with private business and appropriate congressional committees, to study the taxation of Internet activities. The President, within two years of enactment of the bill, would be required to transmit the policy recommendations of the Consultative Group to Congress.

Following action by the Commerce Committee, S. 442 as modified, was referred to the Finance Committee. On July 28, 1998, the Finance Committee reported out S. 442 with a substitute amendment to the Commerce amendment. The Finance amendment made modifications to the length of the moratorium, the definition of Internet services covered by the moratorium, whether existing taxes would be grandfathered, and the makeup and scope of the advisory commission.

The Finance Committee amendment will be the underlying bill; however, a managers' amendment making further modifications to the Finance amendment will be offered. This Legislative Notice reflects anticipated changes made by the managers' amendment.

## **House Action**

On June 23, 1998, the House of Representatives passed similar legislation, H.R. 4105, under suspension (no roll call vote occurred). Also known as the Internet Tax Freedom Act, H.R. 4105 is currently on the Senate calendar (No. 427). It would impose a three-year moratorium on "taxes on Internet access; bit taxes; or multiple or discriminatory taxes on electronic commerce." The moratorium would not apply to taxes currently in effect in Connecticut, Iowa, North Dakota, South Dakota, New Mexico, Tennessee, and Ohio if these states pass a law within a year that expressly affirms that such a tax is imposed on Internet access. The House bill would establish a commission of 31 members: the Attorney General and Secretaries of Commerce and Treasury; 14 representatives from state, local and county governments; and 14 taxpayer and business representatives (7 appointed by the Speaker of the House and the Majority Leader of the Senate, 7 appointed by the Minority Leaders). The commission would develop legislative recommendations (and submit to Congress within two years after the bill's enactment) on the appropriate taxation of Internet activity and other remote area transactions.

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## **BILL PROVISIONS**

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### **Sec. 1. Short Title**

#### **Title I — Moratorium on Certain Taxes**

### **Sec. 101. Moratorium**

- Prohibits the imposition or assessment of State and local taxes on the Internet during the period beginning on July 29, 1998 and ending two years after the date of enactment of the Act.
- The moratorium *would apply to* (1) taxes on Internet access; (2) bit taxes; and (3) multiple or discriminatory taxes on electronic commerce. (See Sec. 104 of the bill, and pps. 5-6 of this Notice, for definitions.)
  - ▶ The moratorium *will not apply*:
    - (1) to any tax that was generally imposed and actually enforced before the date of enactment of the bill;
    - (2) with respect to Internet access that is offered for sale as part of a package of services that includes services other than Internet access, unless the service provider separately states

that portion of the billing that applies to such services on the user's bill; or

- (3) to taxes currently in effect in Connecticut, Iowa, Montana, New Hampshire, New Mexico, North Dakota, Ohio, South Dakota, Tennessee, Texas, Wisconsin, and the District of Columbia. The provision is similar to the grandfather in H.R. 4105, except that the Senate bill does not require these states to re-enact their laws (whereas the House bill requires such action within one year).

- ▶ The moratorium *does not* affect taxes, fees, and other charges imposed pursuant to Federal law, such as the universal service charges currently imposed by the FCC.
- Nothing in the bill is intended to modify, impair, or supersede any State or local law pertaining to taxation that is otherwise permissible by or under the Constitution or other federal law and is in effect on the date of enactment of the bill.
- To restate, new taxes imposed by a state after July 29 are prohibited, except in the states listed above. Taxes currently imposed but not enforced are also prohibited after July 29. Taxes imposed and enforced are prohibited only after the date of enactment of the bill.

#### **Sec. 102. Advisory Commission on Electronic Commerce**

- Establishes an Advisory Commission on Electronic Commerce composed of 19 members to study and recommend appropriate rules for international, Federal, State and local government income and excise taxation of Internet transactions, as well as appropriate tariff treatment.
- The Commission is to be comprised as follows:
  - ▶ Three representatives from the Federal Government — the Secretaries of Commerce and Treasury, and the U.S. Trade Representative.
  - ▶ Eight State and local officials and eight business interests — five of whom will be appointed by the Speaker of the House, five by the Senate Majority Leader, and three each by the House and Senate Minority Leaders.
- The Commission is not given an independent budget, but may accept, use or dispose of gifts or grants of services or property. The Commission is also given reasonable access to materials, resources and facilities, data and other information from the Departments of Justice, Commerce, State, Treasury, and the Office of the U.S. Trade Representative.
- The Committee sunsets 18 months after enactment of the bill.

- In considering the appropriate rules for the tax treatment of Internet transactions, the Committee may examine: (1) barriers imposed in foreign markets on U.S. electronic or telecommunication services; (2) the collection and administration of consumption taxes on electronic commerce in other countries; (3) the impact of the Internet and Internet access on the revenue base for taxes imposed under sec. 4251 of the tax code; (4) model state legislation that would provide uniform definitions of categories of property, goods, services or information subject to or exempt from sales or use taxes and that would ensure Internet activity would be treated in a tax and technologically neutral manner, and (5) ways to simplify the interstate administration of sales and use taxes on interstate commerce and ways to simplify federal, state and local taxes imposed on telecommunications services.

#### **Sec. 103. Report.**

- The Commission must report its findings and recommendations to Congress within 18 months of the bill's enactment.
- For a finding or recommendation to be included in the report, it must have the support of two-thirds of the members of the Commission.

#### **Sec. 104. Definitions.**

- **Bit Tax** — means any tax on electronic commerce expressly imposed on or measured by the volume of digital information transmitted electronically, but does not mean taxes imposed on telecommunications services.
- **Discriminatory tax** — means any tax imposed by a State on electronic commerce that (1) is not generally imposed and legally collectible by the State on transactions involving the same or similar property, goods, services, or information accomplished through other means; (2) is not generally imposed and legally collectible at the same rate on similar property, goods, services or information accomplished through other means, unless the rate is lower; (3) imposes an obligation to collect or pay the tax on a different person or entity than in the case of similar transactions; or (4) establishes a classification of Internet access service providers or online service providers for purposes of establishing a higher tax rate to be imposed on such providers than generally applied to similar information delivered through a different medium.

A discriminatory tax also means any tax imposed by a State (1) if the ability to access a site on a remote seller's out-of-state computer server is considered a factor in determining a remote seller's tax collection obligation, or (2) a provider of Internet access service or online services is deemed to be the agent of a remote seller for determining tax collection obligations, as a result of (a) the display a remote seller's information or content on the server of a provider of Internet access service or (b) the processing of orders through the computer server of a provider of Internet access service.

- **Electronic Commerce** — means any transaction conducted over the Internet or through Internet access, comprising the sale, lease, license, offer, or delivery of property, goods, services or information.
- **Internet** — means the myriad of computer and telecommunications facilities, including equipment and operating software, which comprise the inter-connected world-wide network of networks that employ the Transmission Control Protocol/Internet Protocol to communicate information of all kinds by wire or radio.
- **Internet Access** — means a service that enables users to access content, information, electronic mail, or other services offered over the Internet (but does not include telecommunications services).
- **Multiple Tax** — means any tax that is imposed by more than one State on the same or essentially the same electronic commerce, without a credit for the out-of-tax taxes paid. However, the term does not include a sales or use tax imposed by a State on the same electronic commerce or a tax on persons engaged in electronic commerce which also may have been subject to a sales or use tax.
- **Tax** — means (1) any charge imposed by any governmental entity for the purpose of generating revenues for governmental purposes, and is not a fee imposed for a specific privilege, service or benefit conferred; or (2) the imposition on a seller of an obligation to collect and remit to a governmental entity any sales or use tax imposed on a buyer by a governmental entity.
- **Telecommunications Service** — has the meaning given in section 3(46) of the Communications Act of 1934 (47 U.S.C. 153(46)) and includes communications services (defined in section 4251 of the Internal Revenue Code).
- **Internet Access Tax** — means a tax on Internet access, including the application of any tax on the sale or use of Internet services.

## **Title II — Other Provisions**

**Sec. 201. Sense of the Senate that Internet Should be Free of New Federal Taxes.**

**Sec. 202. National Trade Estimate.**

- Amends section 181 of the Trade Act of 1974 to include barriers to U.S. electronic commerce among the items catalogued in the annual National Trade Estimates report on foreign barriers to trade.

**Sec. 203. Sense of Congress that the Internet Should be Free of Foreign Tarriffs, Trade Barriers, and other Restrictions.**

- Provides a statement of Congressional intent that the President seek international agreements to remove barriers to global electronic commerce and outlines negotiating objectives that should be pursued by the President.

**Sec. 204. No Expansion of Tax Authority.**

**Sec. 205. Preservation of Authority.**

**Sec. 206. Internet Intellectual Infrastructure Fee Ratification Repeal.**

- Repeals section 8003 of Public Law 105-174, effective May 1, 1998.

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## **ADMINISTRATION POSITION**

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At press time, no Statement of Administration position was available. However, the Administration on February 26, 1998, issued a statement saying in part that the President supports a moratorium.

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## **COST**

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The Congressional Budget Office has prepared a cost estimate for both the Commerce and Finance amendments. As of press time, there is not a cost estimate for the managers' amendment. Since the managers' amendment modifies the Finance substitute, this Legislative Notice relies on the CBO estimate of the Finance substitute.

CBO found that enactment of S. 442 would result in new discretionary spending of \$1-2 million over the next five years, resulting from the Commission's expenses.

CBO also concluded that the proposed advisory commission could affect both direct spending and receipts because the Commission is allowed to accept donations. However, CBO estimates that any such donations would be negligible.

With respect to both the Commerce and Finance versions of S. 442, CBO concluded that the moratorium would impose an intergovernmental mandate as defined in the Unfunded Mandates Reform Act (UMRA). CBO could not estimate whether the direct costs of the mandate would exceed the statutory threshold of \$50 million (adjusted annually for inflation).

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## OTHER VIEWS

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### *Additional Views of Senator Graham.*

Senator Graham filed additional views opposing the bill because, as a former governor, he does not believe the federal government should restrict the ability of states to finance important state issues such as education and police protection. He also opposes the bill because his amendment regarding direct marketers failed.

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## POSSIBLE AMENDMENTS

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McCain/Hollings. Managers' amendment (as discussed in this Notice).

McCain/Wyden. Increase the moratorium to five years.

Dorgan. Re. grandfather provisions.

Bumpers/Graham. Require out-of-state direct marketers to collect state and use taxes when the company solicits in the state and delivers products into the state [failed 6-13-1 in committee markup].

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